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July 9, 1990

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P&I Pensions & Investments

The Newspaper of Corporate and Institutional Investing

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AT DEADLINE

Cost cuts could hit fund

McDonnell Douglas' budget-cutting plans could affect its $7.6 billion pension fund.

Under one proposal, the company might replace top-paid department heads with seconds in command. In that case, David Hammerstein, director-retirement funds management, would be replaced by Sheryl L. Kwiatek, manager-retirement funds management.

Another measure could place all of the fund's assets with a passive manager to reduce fees. The fund is heavily indexed now.

404(c) issue reopened

The Labor Department has decided to reissue for public comment its widely criticized proposed regulation on defined contribution plan investment options. The regulation governs section 404(c) of ERISA.

Minneapolis picks CIO

James Hacking, executive director of the Minnesota Public Employees' Retirement Association, has been named executive director and chief investment officer of the Minneapolis Employees' Retirement Fund. He replaces John Chenoweth, who resigned last month.

PCM drops businesses

PCM International is shedding its international equity and fixed-income mutual funds and international fixed-income institutional business to concentrate on international equity management for tax-exempt clients.

The other accounts will shift to other subsidiaries of PCM's parent, Prudential Insurance.

Harris shifts personnel

Jon S. Brightman has been named head of the trust department at Harris Trust and Savings Bank, replacing Richard C. Caldwell, who became executive vice president in charge of trust and money management for both PNC Financial Corp. and its Provident National Bank unit.

Managers selected

The $310 million Norfolk (Va.) Employees' Retirement System hired Newbold's Asset Management Inc. and The Chicago Corp. to run large-cap equity portfolios of $24 million and $47 million, respectively, and the Putnam Cos. Inc. to run an emerging growth equity portfolio of $16 million . . . The $16 billion Pennsylvania Public School Employes' Retirement System hired London & Bishopsgate International Inc. to manage $10 million each in global cash management and fixed income.

Readers' Digest names CFO

Anthony W. Ruggiero, senior vice president and controller of Bristol-Myers Squibb, has been named chief financial officer of The Readers' Digest Association. He succeeds Vernon Thomas, who stepped down for health reasons.

ESOP refinancings save billions

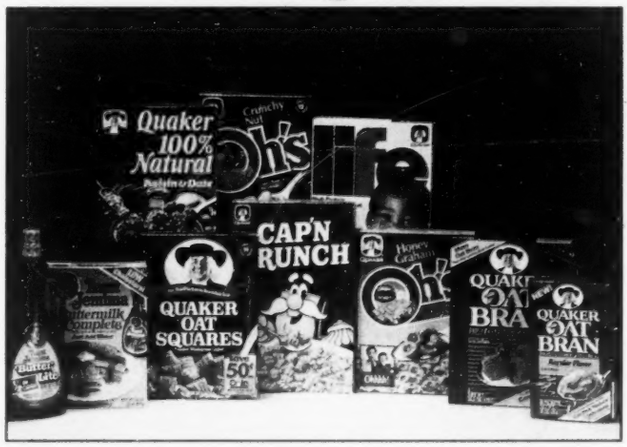
Grantor trusts key to deals

By Marlene Givant Star

A dozen corporations — including Exxon, Square D, Quaker Oats, Xerox and AT&T — have reaped substantial savings by privately placing more than $2 billion in ESOP debt with grantor trusts.

J.P. Morgan Securities Inc., New York, and NCNB Investment Banking Co., Charlotte, N.C., began doing the deals last year, refinancing debt associated with leveraged employee stock ownership plans formed prior to tax law changes. The two firms devised the grantor trust application.

Goldman, Sachs & Co., New York, closed its first such deal for Exxon Corp. June 20. Exxon earlier had refinanced some ESOP debt through J.P. Morgan. In addition, First National Bank of Chicago's merchant bank is working on a couple of grantor trust deals for public companies, and sources say The Travelers Cos., Hartford, Conn., will refinance ESOP debt with a grantor trust to be placed by Chase Manhattan Bank, New York.



Quaker Oats made the last of three private financings for its ESOP through the use of a grantor trust.

The strategy is popular now because companies want to refinance ESOP debt issued when interest rates were significantly higher than they are now.

At the same time, fewer banks are willing to lend to ESOPs this year because write-offs of bad real estate loans and other factors have changed the banks' tax-paying status, limiting their ability to realize tax benefits of ESOP loans.

Still, the market for such deals is fast becoming saturated. Only ESOPs formed before July 10, 1989, can benefit from refinancing through a grantor trust.

In these deals, a grantor trust simultaneously buys debt of an ESOP and finances that purchase by privately placing debt and equity. The loan is repaid by the ESOP, and the grantor trust repays its investors — 80% of them debtholders and 20% equity holders. The equity holders receive the tax advantages associated with the ESOP debt, but only a nominal amount of the interest repaid by the ESOP.

Buyers of the debt, which is taxable, receive the bulk of the interest.

Because they own the ESOP note, equity investors must be qualified lenders to ESOPs — largely banks and insurance companies — but bond investors may include all traditional debt buyers, from pension funds to insurance companies.

In a traditional ESOP financing, all lenders would have to be qualified lenders. Thus, the grantor trust structure broadens the investor base at a time when qualified lenders with tax capacity are limited. Targeting more investors generally means corporations can pay lower rates.

Tax advantages are available because the ESOPs refinanced with grantor trusts have been grandfathered under the old tax law, which provided for a 50% in-

See **Grantor trusts** *on page 34*

New fund makes big equity bet

By Leonard J. Hollie

Time Warner Inc.'s investment strategy for its newly combined $400 million defined benefit pension fund will have a heavy equity commitment and will include its first international allocation.

The company has hired an international manager, two new domestic equity managers and a new master trustee. Other managers from the previous rosters have been retained.

Time Inc. had five defined benefit plans in its master trust with total assets of $250 million, and Warner Communications Inc. had 10 defined benefit plans in its master trust with assets of $150 million.

Merger of the assets was completed July 1, six months after Time acquired Warner in a $14.15 billion deal that created the world's largest

See Time Warner *on page 24*

DC plans tiptoeing abroad

By Curtis Vosti

When Halliburton Co. officials decided in 1985 to invest a portion of the company's defined contribution assets overseas, they got funny looks from the money managers they interviewed.

"When we first went into the ball game, a lot of eyebrows were raised," said Nathaniel Duffield, director of trust investments for Halliburton's $2.5 billion in profit-sharing and employee-directed assets. "I think we were the first defined contribution plan they had talked to about international investing."

Dallas-based Halliburton is not alone among defined contribution plans now investing overseas, but it is among the few. Of the Top 200 employee benefit funds in *Pensions & Investments'* annual survey of the nation's largest funds, 122 offer some sort of defined contribution plan. Only 15 invested internationally (*P&I*, Jan. 22). Together, the 15 accounted for $5.3 billion in international investments — a far cry from the $34 billion the Top 200 defined benefit plans have put overseas.

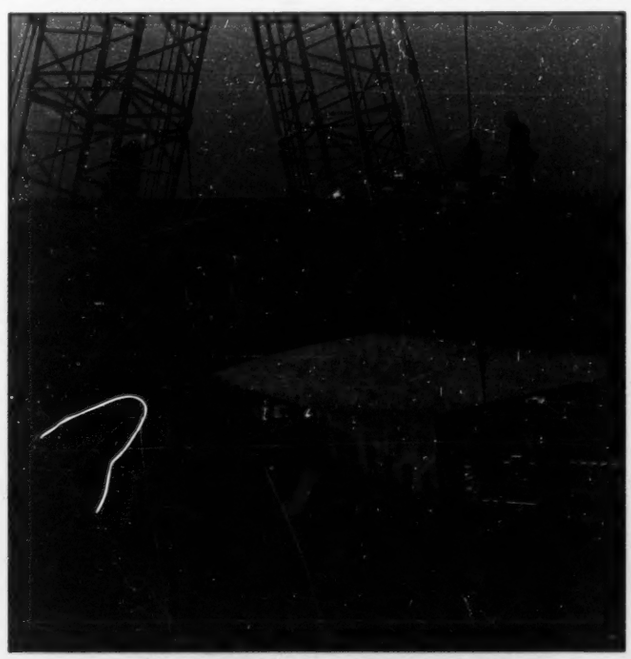
One reason for the gap might be that it's not an obvious option for employees to choose.

In many defined contribution plans — which can combine both company and employee contributions — employees choose investment options for the assets. Many companies do not give the employees a separate option to invest internationally because they think there is not enough interest.

That might change when the Department of Labor's regulations on fiduciary responsibility in defined contribution plans are released.

"A lot of plan sponsors have

See **Overseas wave** *on page 35*



Halliburton, which is working on this road project in Houston, was a pioneer in giving employees the option to invest overseas.

NEWS DIGEST

Robert Shultz will oversee some existing client relationships and new product development in his new job with Trust Co. of the West. Page 4.

Photo by Tom Reed

Rep. Peter Visclosky, speaking at a conference sponsored by *Pensions & Investments*, said he intends to introduce legislation that would change the full funding limits passed in 1987 that he called a mistake. Highlights from the speeches of Rep. Visclosky and other conference speakers begin on Page 6.

FINANCING

Refinancing ESOP-related debt through grantor trusts has attracted a dozen corporations and more than $2 billion in private placements. Page 1.

Disney, Du Pont and Illinois Tool Works have taken advantage of a new wrinkle in convertibles. Page 3.

A bankruptcy law change allows swap deals to be treated on a net basis. Page 24.

Merrill Lynch remained atop the global and domestic underwriting rankings for the first half of 1990. Page 31.

INTERNATIONAL

Halliburton is among the few companies whose defined contribution plans have added foreign investments to their portfolios. Page 1.

The United Nations Joint Staff pension fund seeks to save time and money when its internal global custody system is up and running. Page 3.

The Japanese financial system is undergoing unprecedented regulatory changes. Page 22.

REAL ESTATE

BP America's suit seeking the pension fund's withdrawal from First Chicago's Fund F has the Illinois Municipal Retirement Fund watching closely. Page 2.

Travelers Cos. officials claim the insurer has fulfilled its fiduciary responsibility in response to a suit by the Dallas Police and Fire Pension Fund. Page 20.

JMB Institutional Realty will target developers as a source of deals for its fifth commingled fund. Page 31.

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Real estate survey under way

Questionnaires for *Pensions & Investments'* annual survey of real estate investment advisers have been mailed. The deadline for return of the questionnaires is July 29; the survey will be published Sept. 3. If you qualify for inclusion and did not receive a questionnaire, or have questions about the survey, please contact Christine Philip, directory coordinator, at (312) 649-5217.

Minority firms get boost

California Teachers hires 3

By Steve Hemmerick and Terry Williams

The California State Teachers' Retirement System allocated a total of $600 million to eight new equity managers, including $150 million to three minority firms.

In another development, the State of Connecticut Trust Funds plans to set up a farm team of minority- and women-owned and other emerging money managers that would invest about 10% of the fund's $3.25 billion in equity assets.

Thomas Flanigan, chief investment officer for the $31 billion California Teachers fund, said trustees hired NCM Capital Management Group Inc., Durham, N.C.; Taplin, Canida & Habacht Inc., Miami; and WR Lazard & Co., New York, all firms with at least 51% minority ownership.

Trustees allocated $100 million to NCM Capital, a black-owned value manager; $25 million to WR Lazard, a black-owned growth stock manager; and $25 million to Taplin, Canida & Habacht, a value manager, the majority of which is owned by Hispanic women.

The other managers hired, their styles and allocations, are J & W Seligman & Co. Inc., New York, a growth stock manager, $100 million; Harris Bretall Sullivan & Smith Inc., San Francisco, a growth stock manager, $50 million; Waddell & Reed Asset Management Co., Kansas City, Mo., a rotational stock manager, $100 million; Oppenheimer Capital, New York, a value manager, $100 million; and Sasco Capital Inc., Fairfield, Conn., a value manager, $100 million.

Retained was Barrow, Hanley, Mewhinney & Strauss Inc., Dallas, a value manager, which had its allocation boosted $100 million, to $350 million.

The new allocations came from equity managers dropped during the previous 12 months. Mr. Flanigan declined to identify them.

To give minority firms a greater chance to be hired, California Teachers altered its requirement that a firm be in existence for five years and have $300 million to $500 million under management.

Now, key decision makers at a firm must have at least five years experience and manage at least $100 million.

What is important in hiring managers is the investment experience of the decision-makers in the firm, Mr. Flanigan said.

The rules change was prompted, by state legislation requiring state agencies to give 15% of the value of their contracts to minority-owned firms. Although the legislation permitted the pension fund to meet the 15% requirement by counting any contracts, such as a supplier of typewriter equipment, the pension fund wanted to give some of its assets to minority-owned money managers, said Mr. Flanigan.

The contracts are for three years, with two-year options.

Thomas Flanigan said the Teachers' fund altered search criteria to help minority firms.

Pension Consulting Alliance, a Glendale, Calif., consulting firm assisted in the manager search.

Although guidelines for selecting Connecticut's money managers won't be set until late August or early September, each manager likely will get $10 million to $15 million.

John Winchester, senior vice president and investment officer-pension fund analysis, the farm team will manage the same amount of money normally given to one active manager.

"Everything is preliminary," he said. "Nothing has been firmed up. It's nothing to rush into."

The Connecticut Trust Funds now has one minority money manager, Ariel Capital Management, Chicago, which oversees

See **States** *on page 33*

Kroy trustee hits DOL allegations

By Joel Chernoff

Valley National Bank of Arizona is crying foul against the Department of Labor.

Valley National is upset with the department's lawsuit of last December, which charged the bank with failing to conduct an independent investigation in permitting an employee stock ownership plan to take a 60% stake in the December 1986 leveraged buy-out of Kroy Inc., Scottsdale, Ariz.

The problem, Valley National argues, is not with its work but with the Labor Department's.

In its June 29 filing in the U.S. District Court for Southern New York, Valley National said the Labor Department had cleared the $78 million buy-out prior to its closing on Dec. 23, 1986. Now, the government has announced its policy affecting leveraged buy-outs that include ESOPs and other investors, and wants to retroactively apply it to the Kroy transaction, the bank charged.

The risk could be sizable for Valley National, especially because Kroy, a manufacturer of signage and lettering systems, has been crushed by the burden of debt it assumed in the buy-out. The company filed May 15 for protection from creditors under Chapter 11 of the Federal Bankruptcy Code in the U.S. Bankruptcy Court for Arizona.

While management and creditors are trying to work out a plan of reorganization, a derivative shareholders suit has been filed charging Kroy management with fraudulently perpetrating a scheme to strip the company of its cash while saddling it with huge amounts of debt while making false business projections.

But it's the Labor Department's lawsuit that has riled Valley National.

The department charged the bank had permitted the ESOP to purchase 60% of Kroy's common stock — 50.1% on a fully diluted basis — even though the ESOP was putting up 87% of the equity financing. Other investors, including management, contributed only 13% of total equity financing while receiving 40% of Kroy's stock on an undiluted basis.

The ESOP paid $5.92 for each of the 6 million shares it acquired, while other investors paid only $1.125 per share.

The department charged Valley National was responsible for the ESOP overpaying for the stock because the bank approved the transaction. In speeches made earlier this year referring to the Kroy case, department officials said an ESOP should receive "a dollar's worth of stock for each dollar the ESOP has invested" — the department's first clear iteration of its policy since it effectively had blocked Scott & Fetzer Co.'s proposed leveraged buy-out in 1985.

In addition, Valley National had stepped into the transaction

See **ESOP trustee** *on page 33*

BP America sues to get realty assets

By Terry Williams

CLEVELAND — BP America Inc.'s pension fund is suing First National Bank of Chicago to withdraw more than $17 million BP has invested in Fund F, an open-end real estate fund.

First Chicago also owes more than $41 million to the $4.3 billion Illinois Municipal Retirement Fund, Chicago, which has asked to redeem its share in the fund, said Robert L. Cusma, executive director. His fund is not a party in the BP suit.

The BP suit was filed May 18 in U.S. District Court in Cleveland. BP officials declined to comment, as did David Rowan, BP's lawyer, and Robert Herbert, counsel for First Chicago.

The bank is the trustee of the First Group Trust, which administers Fund F. BP first invested in Fund F in 1979.

In the suit, BP America alleges that First Chicago changed the redemption policy from a first-come first-served basis to a system of pro-rata distributions; that it invested in speculative properties after it became aware of its liquidity problem; and that First Chicago diminished

See **BP America** *on page 33*

FASB

Retiree health liability reckoning pushed back 1 year

■ Reacting to the loud and clear input from plan sponsors, the Financial Accounting Standards Board tentatively agreed to delay the effective date of its proposed change of accounting for retiree medical liabilities.

The date for changing to an accrual basis from a pay-as-you-go method tentatively was moved to fiscal year 1993 from 1992.

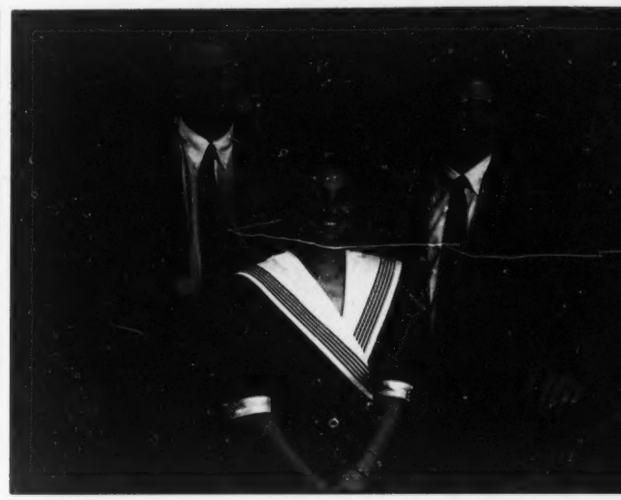
The board also tentatively agreed to allow immediate recognition of accrued liabilities on a one-time basis, said Jane Adams, project manager. Immediate recognition, which was not included in the exposure draft released in February, would be voluntary.

If the option is not selected, Ms. Adams said, accrued liabilities up to the effective date of the proposal would be amortized over a 20-year period, rather than the 15 years contained in the original exposure draft.

Ms. Adams said more than 90% of the responses to the exposure draft requested an immediate recognition provision. She said the one-year delay in implementation would allow companies and industry experts additional time in which to compile the medical claims and cost data on which to base projections under the proposal.

New data compiled by A. Foster Higgins & Co., Princeton, N.J., shows more than half of the employers who provide retiree health benefits have not yet determined their financial liability.

The survey, scheduled for release in July, also revealed that among employers who determined their retiree health liability, 47% found it higher than expected.



James Blair, left, Sharon Manewitz and Damien Kovary of the workout group at TIAA, where active participation is the watchwor

Lynn K. Cherney

John F.C. Parsons

REAL ESTATE

An about-face for next crop of CEOs

■ Real estate CEOs in 2000 will need experience in public affairs, environmental issues, international issues, financial planning, strategy setting, creative thinking and team leadership.

So declared John F.C. Parsons, strategic consulting partner, and Lynn K. Cherney, executive compensation partner, at Ferguson Partners Ltd., a Chicago business advisory services firm.

They developed the profile, noting the image of the chief executive officer as a deal-maker is gone as realty firms become service oriented rather than product driven.

"The service approach will be vital for real estate companies. They will need the fees generated by service to meet their cash flow requirements because of the limited demand expected for office, retail, residential and hotel property."

INTERNATIONAL

'Matchmaker' bridges ocean

■ Interfinance Inc. is doing its part to get U.S. institutional investors up to speed on European investment opportunities — with a twist. The New York-based firm specializes in introducing Europe's small- to medium-cap, high-growth companies to American investors.

The firm hosts monthly luncheons for its institutional clients — including Yamaichi Asset Management and Equitable Capital Management — with the chieftains of Europe's fast-track companies.

So far this year, presentations have been made by Groupo Hispano Suiza, a Spanish importer of construction machinery; Attwoods PLC, a British waste management firm; Group Lyonnaise des Eaux, a French water treatment company; and Groupe Expand, a French drug marketing firm and television programming producer.

Interfinance — which is owned by Tuffier et Associes, a leading French broker — started out six years ago to promote French market investments to U.S. institutions.

Since it was formed, Interfinance has expanded to cover all of Europe, said Arnaud de Vienne, president.

PEOPLE

TIAA group sees innovation daily

■ Sharon Manewitz, Damien Kovary and their colleagues in the workout group at the Teachers Insurance and Annuity Association, New York, spend their days at the bargaining table figuring out how to save troubled investments and pressing bondholders' rights.

With dealmaking depressed and bank financing dwindling, they say the $49 billion pension fund is taking more equity stakes in revitalized companies. "Equity is becoming a greater component in the solution. . . . The exit strategy is leaning less toward mergers and acquisitions because you need financing — and it's not available," said Mr. Kovary, second vice president.

TIAA has lived by the motto that active participation in the workout process pays off in maximized recovery of assets and minimized losses.

For TIAA, "problem" loans range from companies relegated to the watch list with an early warning flag to firms that have filed for bankruptcy. These troubled investments make up less than 1.5% of TIAA's assets.

"It's very much a game without rules," said James Blair, vice president-administration/finance who oversees the group.

Ms. Manewitz, an investment officer, and Mr. Kovary find their jobs challenging, partly because the fund is often a mezzanine lender instead of the first-in-line senior lender. They say that gives them more room to fashion creative solutions.

SWAPS

A big year in '89

■ The worldwide swap market approached $2 trillion in 1989, according to the latest survey by the International Swap Dealers Association Inc.

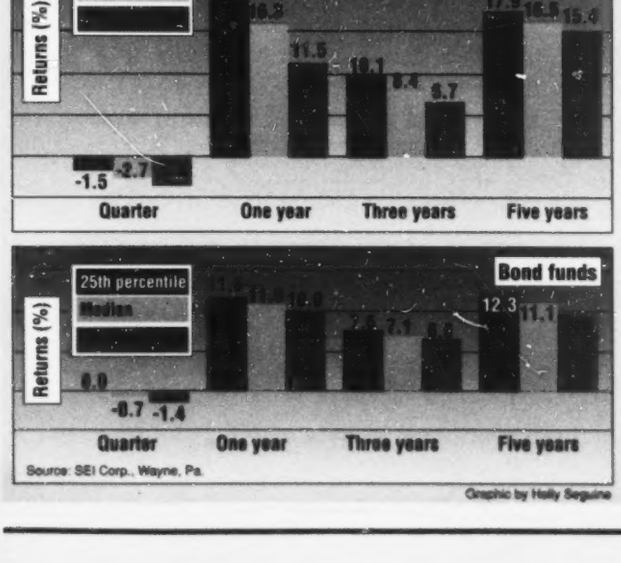
The total value of swaps outstanding in 1989 exceeded $1.1 trillion, up 46% from $1.3 trillion the previous year.

Of that amount, interest rate swaps accounted for about 75% of the total, or $1.5 trillion. Currency swaps accounted for another $435 billion.

SEI universe performance

(periods ended March 31)

The S&P 500 Stock Index returned -3.0% for the quarter, 19.3% for the year, 8.9% for three years and 16.1% for five years. The Salomon Brothers Broad Index returned -0.8%, 12.2%, 7.5% and 11.7% respectively. Returns for periods greater than one year are annualized.



Source: SEI Corp., Wayne, Pa.

Graphic by Holly Seguine

SAVINGS & LOANS

Another stunner added to the list

■ Add one more mind-boggling estimate to the hodgepodge of conflicting best guesses of what it ultimately will cost taxpayers to bail out the nation's sick thrifts.

Goldman, Sachs & Co.'s estimated price tag is $183 billion, although the investment bank says "there is a significant risk that our estimate may be too low, in part because the losses on asset sales could be higher than we have estimated and the number of thrifts that may ultimately fail could be considerably greater than 1,000."

Astonishing as that $183 billion estimate is, it's lower than the General Accounting Office's $325 billion but higher than Treasury Secretary Nicholas Brady's best guess of somewhere between $90 billion and $130 billion.

Goldman's estimate includes not just the cost of liquidating 1,000 thrifts, but $50 billion to honor the income maintenance and asset quality guarantees of the Federal Savings and Loan Insurance Corp. and $10 billion for administrative expenses. The investment bank's estimate omits interest expenses and some other costs, such as capitalizing the FSLIC's successor, the Savings Association Insurance Fund, which are included by the GAO. Also unlike the GAO, Goldman's estimate is calculated on a present value basis, which reduces the size of its estimate.

Thrift crisis costs
($ billions)

	Present value estimates		
	Goldman	Brady's	GAO *
Closing troubled thrifts	123	90 - 130	87
FSLIC guarantees	50		68
Administrative expenses	10		19
Interest			
RTC working capital			28
Refcorp interest			74
Financing Corp.			31
Other ▪			18
TOTAL	183	90 - 130	325

* GAO estimates cover 1990 - 1999 period except for interest, which includes all interest on outstanding FICO and Refcorp bonds until maturity.
▪ Lost tax revenue from FSLIC transactions and costs of establishing a Savings Association Insurance Fund.
Source: Goldman, Sachs & Co., New York.

FROM THE EDITOR

Anti-military social funds irresponsible

Money managers and mutual funds that prohibit investment in defense stocks are implying the Constitution is immoral. At least, that's the way it seems to me. There are five "socially responsible" mutual fund organizations and possibly 10 money management organizations seeking pension assets that avoid defense stocks for moral, rather than investment, reasons.

Many of these investors and managers extend their restrictions to Treasury bonds and bills. Thus, they refuse to lend to the government money to carry out its constitutional mandate. I've never understood how it is "socially responsible" to seek to deny the government the wherewithal to defend the country in a still very dangerous world.

And I've never understood how it is socially irresponsible, or morally reprehensible, for companies to provide equipment the government needs to fulfill its constitutional mandate to defend the country.

The Constitution's preamble specifies the provision of the common defense as a major purpose of the union of the colonies into the United States. Article I, Section 8 of the Constitution gives Congress the power — in fact, the responsibility, in light of the preamble — to provide for the common defense. Section 8 is even more specific. It gives Congress the power to declare war, to raise and *support* armies, and to "provide and maintain a Navy."

Defense companies make it possible for the government to carry out its constitutional duties. If investors, by denying them capital, drove them out of business, or at least out of the defense business, the government's task would be difficult.

The government could buy all of its military equipment from foreign suppliers, such as the Japanese, the British or the French. But military supplies from such sources would be unreliable (if only because lines of supply could be interrupted) and might be far more expensive than they now are. The government could, alternatively, operate its own factories.

The investors and managers who exclude defense stocks do so on several grounds. First, according to Scott Klinger, vice president, Franklin Research & Development Corp., Boston, one of the first and most successful socially oriented managers, they don't want to participate in an industry that makes products the purpose of which is to kill people.

Second, they believe defense companies are less productive for the economy than non-defense companies. For example, intercontinental ballistic missiles simply sit in holes in the ground. Third, the defense industry is extremely cyclical, and on that basis is to be avoided.

The last point is a logical investment reason. The others I can't support. By the logic of the first reason, supporters of the non-defense stock approach should also demand the police either be pulled off the streets or patrol them unarmed. It ignores the possibility that being prepared for war might deter war and save lives.

By the logic of the second argument, they ought also avoid companies that produce anything that is purely ornamental or ephemeral, such as entertainment. Now, I wonder how these funds feel about companies that make war movies?

Mike Clowes

"YEAH, YEAH, YOU WON...SO, CONGRATULATIONS AND NO CUTTING IN LINE!"

LTV still a huge loss

The Supreme Court's decision to return $3.2 billion in liabilities from three pension plans to The LTV Corp. raises a number of questions, unanswered by the Pension Benefit Guaranty Corp.'s vindication by the ruling.

After nearly four years, the PBGC's battle with the Dallas-based diversified manufacturer isn't over yet. Since the plans' terminations in January 1987, the PBGC has paid some $300 million out of its own funds to pay beneficiaries, while during this same time LTV stopped paying millions in premiums for the pension guaranty insurance, the exact total unspecified. In addition, the PBGC assumed $230 million in unfunded liabilities of a fourth, salaried employees pension plan it isn't returning to LTV.

One question is the PBGC's standing among other creditors in the bankruptcy proceeding. It will have to seek reimbursement for those huge payments and subsidies. Those payments amount to among the largest liabilities the PBGC has ever assumed from a company, even after returning the $2.5 billion in unfunded liabilities of the three plans to LTV.

Another question is LTV's response to the Supreme Court's ruling. It hasn't addressed the ruling other than to reiterate its plea of poverty in paying these pensions. Altogether, the three LTV pension funds have only $700 million in assets to fund the $3.2 billion in liabilities. The court's decision will impede LTV's emergence from bankruptcy, according to analysts at major debt-rating companies, although the PBGC thinks LTV is financially fit, even after reassuming the unfunded pensions, to come out of bankruptcy.

That leads to another question: Just how healthy and competitive is LTV? Some justices believe there is serious doubt about such forecasts of its viability. The PBGC could one day find the LTV plans again in its hands, if the Supreme Court's decision pushes the company to the wall.

The future holds the answer to these questions. At this point, though, it makes sense to return the plans to LTV. If the decision had gone the other way, the questions might be about the long-term viability of the pension insurance program rather than about LTV.

SEC's measured idiocy

The Securities and Exchange Commission wants money managers to deduct fees from their investment performance in advertising materials. It's a bad idea.

Many pension industry executives oppose the new rule in unequivocal terms, calling it "mumbo jumbo," "idiocy" and "lunacy."

No one at the SEC appears to be listening to the complaints.

Such deductions for, say, mutual funds make sense, when everyone pays the same management fees.

But pension sponsors negotiate fees. The new rule won't help a pension executive's evaluation of money managers, because the average fees deducted from investment returns, as required by the SEC, will be either too high or too low from those that actually would be paid by the prospective pension fund client.

The rule is contrary to the performance measurement guideline of the Association for Investment Management Research. That standard, widely supported in the industry, shows performance before any deduction for fees.

The trend in the industry, pushed by pension sponsors, has been to unbundle costs. Under the SEC rule, managers may show for individual presentations performance without deducting fees. But it's a long process from a manager's first introduction to being invited by a sponsor for an interview. Much of the research in the initial screening comes from general materials of the manager. How is a sponsor served by comparing two managers, whose returns, net of fees, are identical, but whose performances before such fee deductions show a wide spread? The SEC hasn't explained. It should rescind the rule.

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Japanese businesses adapting to changes

An unprecedented rate of change in the regulation of the Japanese financial markets is touching virtually every business from insurance to securities, an investment banking study reveals.

The Japanese financial system is being restructured by the dual catalysts of changing regulation and domestic competition, according to the report, "The Japanese Banks: Emerging Into Global Markets," by Salomon Brothers Inc.

These changes will create more opportunities for banks and other financial institutions to raise money, and will set the stage for the fuller emergence of these gigantic institutions into the financial markets of the United States and a uniting Europe, the report said.

The continued deregulation of Japan's financial markets has been accompanied by the introduction of new products, the report said. One of the biggest success stories has been the creation of commercial paper, which is rapidly being followed by swaps, futures and options.

Japanese banks also are willing to take bold steps, according to the report. For example, the recently announced merger of Mitsui Bank and Taiyo Kobe Bank will create Japan's second largest institution.

The deregulated financial markets in Japan and abroad are forcing the banks to develop the skills and customer bases necessary to be effective players in the global capital markets, the report said.

Changes in Japan's financial market regulations, according to the report, fall under five broad areas: deregulation of interest rates in the deposit and loan markets; restructuring of the domestic money markets by the Bank of Japan; a detailed reconsideration of Article 65, Japan's version of the U.S. Glass-Steagall Act, which separates the banking and securities businesses; changes in the pensions, investment management and savings sectors; and rapid development of new markets in commercial paper, mergers and acquisitions and futures and options.

The report focuses on eight of Japan's largest banks — Bank of Tokyo, Dai-Ichi Kangyo Bank, Fuji Bank, Industrial Bank of Japan, Mitsubishi Bank, Mitsui Bank, Sanwa Bank and Sumitomo Bank — which raised an unprecedented $19.6 billion in 18 months, primarily from the domestic equity markets. ■

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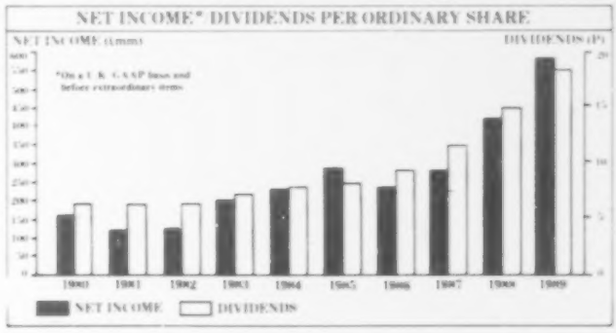

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PIPER addendum

Editor's note: *The following firms had funds that missed the deadline, were omitted or were in error when listed in the Pensions & Investments' Performance Evaluation Report for periods ended Dec. 31. All figures, except PIPER and PIPER+ international, are for funds that would have placed in the top two deciles of their universe. Information was provided by Robin Stadler of Rogers, Casey & Associates, which compiles PIPER and PIPER+. All figures for periods of more than one year are compound annualized.*

Mutual of New York's Fixed-Income PIPER Private Placement Fund returned 5.5% for the quarter, 10.6% for the three-year period, 12.9% for the five-year period and 12.7% for the 10-year period.

Provident Capital's International PIPER Low P/E Fund returned 4% for the quarter, 23.4% for one year and 23.5% for three years.

State Street Bank's International PIPER Index Fund returned 4.6% for the quarter, 10.8% for one year and 20.9% for three years.

Bridgewater Asset Management's Fixed-Income PIPER+ Market Timing Fund returned 4.5% for the quarter, 20.6% for the year, 11.2% for three years and 18.7% for five years. ■

Bankers' fees tumble despite rise in volume

By Marlene Givant Star

The U.S. new issues market steamed ahead in the first six months of 1990 to $163 billion thanks to a booming stock market and a surge in mortgage- and asset-backed securities.

Yet the 13% rise in new issue volume failed to salvage fee income of investment banks. Disclosed fees tumbled to their lowest level in five years — $1.2 billion — reflecting the departure of both the high-yield market and takeover fever.

"The loss of the junk-bond market is synonymous with the end of the era of huge fees," noted a report by Securities Data Co., Newark, N.J.

While the investment banking business is changing to adapt to the low fee environment, the first half's underwriting rankings held few surprises. Merrill Lynch & Co., New York, took top honors domestically and worldwide, reflecting its strength in the retail market and in asset-backed securities and corporate bonds.

The only big shift in rankings occurred in the global arena, where Japanese investment banks, excluding top-ranked Nomura Securities Co. Ltd., lost ground to Swiss and German banks. Global underwriting as a whole declined 28% as the Tokyo stock market decline had repercussions in the Eurobond market and international stock markets.

The declines in corporate bond issuance and initial public offerings, coupled with the the lull in junk bonds and mergers and acquisitions, have changed the dynamics of the underwriting business.

"Stock prices are high but people are concerned about the economy and financial risks and that has put a chill on all kinds of underwriting generally," said John Keefe, vice president of Barclays de Zoete Wedd Securities Inc., New York.

Even with well-publicized brokerage firm cutbacks, "with this much weakness underlying the underwriting process, do firms really need to be this big?" he added.

First half 1990 underwriting rankings

(Full credit to book manager)

All issues - global

Manager	Volume ($ mils.)	Market share (%)
1. Merrill Lynch (1)	28,835.5	11.4
2. Goldman, Sachs (3)	24,114.7	9.5
3. First Boston* (2)	23,605.9	9.3
4. Morgan Stanley (6)	20,080.7	8.0
5. Salomon Brothers (5)	19,805.0	7.8
6. Lehman Brothers (7)	12,912.9	5.1
7. Bear, Stearns (12)	11,690.6	4.6
8. Nomura Securities (4)	9,419.3	3.7
9. Kidder, Peabody (14)	9,206.5	3.6
10. Prudential-Bache (13)	6,953.2	2.8

* First Boston/Credit Suisse First Boston
Numbers in parentheses show the firm's first-half '89 ranking
Source: Securities Data Co., Newark, N.J.

All issues - domestic

Manager	Volume ($ mils.)	Market share (%)
1. Merrill Lynch (1)	26,302.5	16.1
2. Goldman, Sachs (2)	21,187.9	13.0
3. First Boston (3)	17,655.7	10.8
4. Morgan Stanley (7)	17,581.1	10.8
5. Salomon Brothers (4)	16,128.8	9.9
6. Bear, Stearns (8)	11,690.6	7.2
7. Lehman Brothers (5)	11,498.1	7.1
8. Kidder, Peabody (10)	8,963.7	5.5
9. Prudential-Bache (9)	6,864.3	4.2
10. PaineWebber (11)	3,643.7	2.2

Numbers in parentheses show the firm's first-half '89 ranking
Source: Securities Data Co., Newark, N.J.

Disclosed fee analysis

Manager	Volume ($ mils.)	Market share (%)
1. Merrill Lynch (2)	172.6	14.9
2. Goldman, Sachs (3)	171.7	14.8
3. Alex. Brown & Sons (9)	114.3	9.8
4. Salomon Brothers (8)	107.4	9.2
5. First Boston (4)	89.5	7.7
6. Morgan Stanley (10)	82.4	7.1
7. PaineWebber (6)	80.0	6.9
8. Lehman Brothers (5)	78.6	6.8
9. Smith Barney (11)	49.2	4.2
10. Kidder, Peabody (14)	24.9	2.1

Numbers in parentheses show the firm's first-half '89 ranking
Source: Securities Data Co., Newark, N.J.

One thing is certain — Wall Street lost its sex appeal this year. Government-guaranteed mortgage- and asset-backed securities were king in the first half, accounting for 55% of all money raised in new issues.

Declining bond prices and higher than anticipated interest rates sent the corporate debt market into a tailspin. Only $54.1 billion was raised during the first half of 1990, a 26% decrease from 1989's comparable period — representing the smallest amount of money raised in the sector since the second half of 1985. More than 70% of the issues were rated single A or better.

Bond investors flocked to the safety of government-guaranteed issues. Asset- and mortgage-backed securities had their greatest semiannual volume to date, raising $89.8 billion in the first half vs. $56.4 billion in the first six months of 1989. First Boston Corp., New York, was the top underwriter with $11.7 billion for a market share of 13.1%, relying on asset-backed securities for 43% of its business. Bear, Stearns & Co., New York, with 96% of its business coming mortgage-backed securities, was a very close second with $10.3 billion and an 11.4% market share.

Merrill Lynch was No. 1 in straight debt, excluding mortgage- and asset-backed securities, raising $13.6 billion for a market share of 25.1%. The structure of its business changed dramatically, with issuance by commercial banks and savings and loans sinking to 10% from 25% of underwriting activity. Morgan Stanley & Co., New York, was the only bank to almost double its market share in straight debt, to 23.2% in 1990 from 11.7% a year earlier. It ranked second, with $12.5 billion.

Merrill Lynch retained its top position domestically, with $26.3 billion in overall new issues, but its market share slipped to 16.1% from 17.5% because of a decrease in equity-related activity. The firm's stock underwriting market share fell to 9.4% from 13.9% in the 1989 period. Goldman, Sachs & Co., New York, took second place in total domestic new issues, raising $21.2 billion.

The lack of issuance by financial institutions prompted both firms to turn to industrial issuers for about 20% of their financings, according to Securities Data. First Boston ranked third with $17.7 billion and a market share of 10.8%.

Globally, Merrill Lynch, with $28.84 billion, was the No. 1 underwriter, capturing 11.4% of the $252 billion marketplace. Goldman, Sachs ranked second with $24.1 billion and a 9.5% market share.

The stock market's renewed strength and the desire of companies to deleverage by issuing stock to retire debt catapulted common stock offerings to 308 in 1990's first half vs. 184 a year earlier. Volume surged 45% to $12.9 billion. Goldman, Sachs was the leader with $2.5 billion and a 19.1% market share.

Initial public offerings slumped, raising only $7 billion, apace with the meager $6 billion raised in the 1989 period. Alex. Brown & Sons, Baltimore, took the top underwriting spot in IPOs with $1.5 billion, mostly in closed-end funds.

The dive of the Tokyo stock market and higher interest rates in Japan affected European markets as Eurobonds and international equities dropped 28% from their first-half '89 level to $89.6 billion in 1990's first half.

Despite a 50% drop in dollar volume, Nomura Securities, Tokyo, remained on top of the Euromarket charts with $8.5 billion representing 9.4% of the market. But other Japanese banks that had topped the leagues in the 1980s were displaced by Deutsche Bank, Credit Suisse First Boston and Union Bank of Switzerland, taking second, third and fourth places, respectively.

Bonds denominated in European currency units soared to a record $11.4 billion, representing an increase of more than $5 billion from 1989's first half. This corresponded to a market share increase to 14.3% from 5.4%.

Japanese companies' Eurobond issuances plunged to $10.2 billion from $43.4 billion. The collapse of Tokyo stock market extinguished Japan's market for bonds with warrants, which previously had represented 87% of all Japanese Eurobond offerings. ■

JMB set to close 5th fund

Properties to come from cash-strapped developers

By Steve Hemmerick

JMB Institutional Realty Corp., Chicago, is about to close a $380 million commingled real estate fund that should benefit from the current bank and savings and loan liquidity crisis.

According to JMB executives, developers strapped for cash for new projects now are more willing to sell interests in some of their best properties.

More than 36 pension funds contributed to Fund V. Despite the number of contributors, it appears the fund will close with less than the $400 million to $500 million JMB had sought.

Pension fund contributors include: Amsted Industries; Anheuser-Busch; Bell Communications Research; Booz, Allen Hamilton; city of Boston; California Teachers' Association; Christian Schools International; Colgate-Palmolive; Cook County (Ill.); Ernst & Young; Evangelical Health Systems; Ford Motor; Kellwood; Knight-Ridder; Louisiana Employees'; Massachusetts Institute of Technology; NADA Retirement Trust; New York State & Local Retirement Systems; Rohr Industries; Ryder Systems; Tallahassee (Fla.); Tulare County (Calif.); United Food & Commercial Workers International; and United Illuminating Co.

Although not yet closed, JMB has begun buying properties for the fund. It paid $18.2 million for an 85% interest in the Madonna Road Plaza, a 308,000-square-foot shopping center in San Luis Obispo, Calif.

The initial yield, according to JMB executives, is about 7%. However, because of local building constraints, population growth and the possibility of redeveloping the regional mall, JMB estimates the final total return on the project to be 11.5%.

Built in 1968, the plaza serves San Luis Obispo County, which JMB contends is a prime growth area in California.

The remaining 15% interest in the Madonna Road Plaza is held by a JMB fund for endowments and foundations.

JMB Fund V also paid $43.3 million for a 50% interest in 1200 New Hampshire Avenue, an eight-story, 272,000-square-foot office building in Washington. An unidentified JMB separate account client bought the other 50%.

The building is 100% leased to the law firm of Arnold & Porter. When that lease expires in 1994, JMB plans to renovate the building and re-lease the office space to multiple tenants. Because of rigid zoning laws and other barriers, JMB should be able to raise rents, JMB executives said.

While the initial yield to JMB Fund V participants should be about 7%, the expected total return should be 11.1% when the building is sold.

An official for one of the funds that invested with the JMB fund, O. Gerald Fields, chief executive officer for the Tulare County Employees' Retirement Association, said JMB's sheer size and its past performance were some factors in choosing to invest in Fund V.

"I think mainly we like the size of the company (JMB), and we liked the diversification offered by their investment goals, in terms of geography and property types," said Mr. Fields.

His fund put $5 million in the JMB fund. Tulare County has about 11% of its assets in real estate and a target of 15%. The San Francisco branch of the consulting firm SEI Corp. assisted the Tulare fund in its search.

Real estate funds now in the process of investing assets are likely to find opportunities they wouldn't ordinarily see, according to Paul Saint-Pierre, president of the real estate consulting firm Pension Realty Advisors, San Francisco.

Mr. Saint-Pierre agrees with JMB officials that because of the tightened bank and savings and loan regulations, less money is available to developers.

As a result, developers are more willing to offer interests in some properties they hold, or sell them outright.

"The Homart-Yarmouth fund is a classic example of that," said Mr. Saint-Pierre. Earlier this year, Homart Development Co., Chicago, announced an agreement with The Yarmouth Group, New York, to offer a private placement real estate investment trust, Homart Institutional Partners, which will attempt to raise $700 million from domestic and foreign institutional investors. The trust is composed of property owned by Homart.

"We've seen others working on a couple of (similar) transactions, where they come to the market in an investment banking type of transaction where a developer is stapled together with an investment manager, and the investment manager is out shopping the whole package," said Mr. Saint-Pierre. ■